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August 19, 2003

FILED VIA ECFS

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: ***Petition for Forbearance from the Current Pricing Rules for the Unbundled Network Element Platform*, WC Docket No. 03-157 - Errata**

Dear Ms. Dortch:

Association of Communications Enterprises, CIMCO Communications, Inc., Granite Telecommunications, Inc. and Lightyear Communications, Inc. herewith submit the attached corrected version of their Comments filed on August 18, 2003 in the above-referenced matter. The corrected version adds Lightyear Communications, Inc., which was inadvertently omitted from yesterday's filing. Attached is a corrected version of the Comments.

Should you have any questions regarding this matter, please do not hesitate to contact the undersigned.

Respectfully submitted,

William B. Wilhelm
Michael P. Donahue

Counsel for Association of Communications Enterprises, CIMCO Communications, Inc., Granite Telecommunications, Inc. and Lightyear Communications, Inc.

Enclosure

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Petition for Forbearance From	)	
The Current Pricing Rules for	)	WC Docket No. 03-157
The Unbundled Network Element	)	
Platform	)	

COMMENTS OF
ASSOCIATION OF COMMUNICATIONS ENTERPRISES,
CIMCO COMMUNICATIONS, INC.,
GRANITE TELECOMMUNICATIONS, INC., AND
LIGHTYEAR COMMUNICATIONS, INC.

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August 19, 2003

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SUMMARY

The Commission should reject Verizon's Petition for the simple reason that TELRIC, which focuses on forward-looking, efficient costs, rather than historical costs is the appropriate pricing standard for unbundled network elements ("UNEs"). Verizon has failed to provide any valid basis for the Commission to return to the inefficiencies of historical cost based ratemaking.

Verizon's arguments that TELRIC produces costs below what ILECs can match and therefore discourages investment fly in the face of reality. RBOCs still control nearly 90% of the access lines in the United States. If they RBOCs could not match the competitive prices produced by TELRIC, one would expect this percentage to be smaller. Moreover, until the recent economic downturn resulting from a sluggish economy and closed capital markets, TELRIC produced significant increases in investment by both RBOCs and competitive carriers.

Verizon's complaints that TELRIC has produced "artificially low rates" are similarly without merit. It is not surprising that as state commissions conduct subsequent rounds of TELRIC proceedings, and thus become more experienced with the process, the rates resulting from those proceedings are lower. Similarly, new developments, technologies, and information lead to lower rates, which enable carriers to become more efficient, also lead to lower rates. The financial analysts' studies Verizon claims demonstrate that UNE rates are too low do not offer a definitive basis for overturning these state commission determinations. These studies were prepared by organizations whose expertise is not to conduct cost proceedings, and do not trump the findings of state commissions that have been setting RBOC rates for years.

In addition, sections 251(c) and 271 pose obstacles to Verizon's Petition because the Commission is statutorily proscribed from forbearing from these requirements. Thus, the Commission cannot forbear from TELRIC until it determines that the requirements of section 251(c) and 271 are fully met.

Moreover, the arguments raised by Verizon's Petition were specifically rejected by the Supreme Court when it affirmed the Commission's TELRIC rules. The Court noted that under the local competition provisions of the Act, Congress called for ratemaking different from any historical practice, to achieve the new objective of uprooting the monopolies that traditional rate-based methods had perpetuated. The Court observed that the 1996 Act appears to be an "explicit disavowal of the familiar public-utility model of rate regulation . . . in favor of novel ratesetting designed to give aspiring competitors every possible incentive to enter the local retail telephone markets, short of confiscating the incumbents' property." TELRIC meets this requirement since it treats cost as a "forward-looking economic cost" rather than a "historically based cost." In fact, the Court stated that the Commission "would have had some more explaining to do if it had not changed its course by favoring TELRIC over forward-looking methodologies tethered to actual costs, given Congress's clear intent to depart from past ratesetting statutes in passing the 1996 Act." Verizon has offered no valid reason to return to the very type of historical ratemaking Congress sought to proscribe through the 1996 Act.

Contrary to Verizon's claim that TELRIC discourages investment, numerous studies show TELRIC actually promotes BOC investment and consumer welfare. As an initial matter, the Supreme Court specifically rejected the notion that TELRIC does not promote investment, noting that such a claim "founders on fact." As the Court observed, new entrants invested nearly $55 billion in facilities following passage of the 1996 Act through 2000. Nor has TELRIC stymied RBOC investment. During the same period, RBOCs invested over $100 billion in new facilities. Verizon ignores this data and instead focuses on the recent downturn in investment, which, contrary to Verizon's claims, has been caused by the recent economic downturn and resulting closure of capital markets across a broad spectrum of industries.

The Commission should also reject Verizon's request to prohibit CLECs from recovering access charges over UNEs. As providers of competitive exchange access services, CLECs are permitted to collect access charges for exchange access traffic originated or terminated over o a CLEC's facilities, regardless of whether the facilities are leased or owned by the CLEC. In addition, collecting access charges on purchased UNE facilities enables a CLEC to recoup a portion of the cost of those facilities. The ILEC, in turn, is able to recover the cost of its underlying infrastructure through the cost-based UNE rates. There is no reason to permit the ILEC to double recover its costs by also collecting access charges for exchange access traffic terminated to UNE facilities, as Verizon suggests.

Indeed, Verizon's proposal highlights its true purpose – recovering at least the cost of its facilities through non-TELRIC-compliant UNE charges while at the same time receiving windfall access revenues for the same facilities. It is just such monopolistic behavior that is the reason for the 1996 Act and the Commission's rules implementing that act.

In stark contrast to the negative implications of Verizon's proposal, Verizon has not demonstrated that interim relief is necessary. Contrary to Verizon's claims, BOCs are experiencing robust financial performance, despite the downturn in many other industries. In addition, forbearance as requested by Verizon would disrupt state Triennial Review implementation proceedings and undermine the purpose of the Commission's proposed three-year UNE-P transition in certain markets.

Verizon's Petition fails to satisfy the statutory requirements for forbearance. Verizon's arguments opposing the current pricing rules can be boiled down to a claim that any rule that reduces Verizon's profits is inappropriate and should be eliminated. On the contrary, the current pricing rules are not intended to protect Verizon's profits, but to ensure that Verizon charges just and reasonable rates and cannot discriminate against its competitors. The rates produced by the current pricing rules are not, as Verizon claims "below any rational measure of costs," but within a zone of reasonableness supported by the forward-looking costs of a reasonably efficient incumbent. Further, Verizon ignores the fact that UNE rates are not determined arbitrarily or in a vacuum, but are based upon cost data provided by Verizon. If it fails to produce cost data that accurately reflects Verizon's costs, Verizon can only place the blame on itself and it should not be permitted to foist its shortfalls on its competitors in order to protect its profits.

Moreover, the current UNE rules are necessary to protect consumers. Lower UNE rates produce more competitive options and ultimately lower the cost of telecommunications services to consumers. The Commission has recognized that the availability of UNEs enables competitors to enter a new market immediately, begin signing up customers and generating revenues, which can, in turn, offset some of the costs of network deployment, while its network is being deployed. Regardless of the variety or quality of a competitors service offerings, those benefits may not be economically available to consumers if the CLEC is forced to deploy expensive, redundant facilities prematurely, which is the "investment" Verizon encourages.

In addition, a CLEC relying on UNEs has the flexibility to provide a broad range of competitive services offerings to consumers. Foreclosing the flexibility provided by UNEs or making them less economic by prohibiting CLECs from collecting access charges on UNE facilities, rather than promoting customer options, could actually reduce the number of competitors in a market, thereby effectively reducing the competitive options available to consumers in that market.

Finally, the existing pricing rules are necessary to promote the public interest. A regulatory regime like that proposed by Verizon in which every carrier, including those that are only just entering a particular market, is required to construct facilities to every customer, would effectively preclude competition. Rather, the public interest is served by a regulatory regime that not only enables new entrants to obtain access to facilities to serve their customer immediately, and thus establish themselves in the market, but also provides the CLEC the flexibility to determine when and where to deploy its own facilities to duplicate the ILEC's network. The current pricing rules provide such an environment. Verizon's forbearance proposal, on the other hand, may increase Verizon's profits, but it will lead to fewer options for consumers.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Petition for Forbearance From The Current Pricing Rules for The Unbundled Network Element Platform	))))	WC Docket No. 03-

COMMENTS OF
ASSOCIATION OF COMMUNICATIONS ENTERPRISES,
CIMCO COMMUNICATIONS, INC.,
GRANITE TELECOMMUNICATIONS, INC., AND
LIGHTYEAR COMMUNICATIONS, INC.

The Association of Communications Enterprises, CIMCO Communications, Inc., Granite Telecommunications Inc., and Lightyear Communications, Inc. submit these comments concerning the petition of the Verizon Telephone Companies ("Verizon") requesting forbearance from application of TELRIC pricing to the unbundled network element platform ("UNE-P").[1] Verizon also requests that the Commission prohibit UNE-P providers from collecting interstate access charges. For the reasons stated below, the Commission should deny the petition.

I. TELRIC PRICING MUST BE RETAINED

A. TELRIC Is the Correct Pricing Standard for UNEs.

The Commission should reject Verizon's Petition for the very simple reason that TELRIC is the appropriate pricing standard for unbundled network elements ("UNEs"). For the Commission to grant Verizon's Petition, and determine that forbearance from the Commission's

[1] *Pleading Cycle Established for Verizon Petition for Expedited Forbearance From the Commission's Current Pricing Rules for the Unbundled Network Element Platform*, Public Notice, WC Docket No. 03-157, DA 03-2189, released July 3, 2003; *Order*, WC Docket No 03-157, DA 003-2333, released July 15, 2003.

pricing rules is in the public interest, will promote competition and produce just and reasonable rates, the Commission must find that Verizon's contentions regarding TELRIC are correct. Considering the fact that Verizon's support for its Petition is comprised of merely rhetoric and unsubstantiated statistics, Verizon is essentially asking the Commission to assume that its views are valid. Many of the arguments that Verizon raises, however, constitute basically a recapitulation of arguments that were explicitly rejected by the U.S. Supreme Court. Moreover, its statistics are incomplete at best, and misleading. Finally, even assuming *arguendo* Verizon's assertions, its arguments boil down to a laundry list of purported maladies it has experienced with no causal link to TELRIC demonstrated. As a review of its arguments demonstrates, Verizon has simply failed to provide the Commission with a basis to attach validity to any of its claims.

First, Verizon contends that the Commission's TELRIC rules are grounded not in the incumbent's existing network, but in a hypothetical network.[2] As discussed in more detail below, the U.S. Supreme Court found the Commission's use of a forward-looking network approach not only permissible but also appropriate given the inefficiencies and inflated costs rooted in RBOC networks. A focus on the RBOCs' "actual" costs would undermine the goals of the 1996 Act. Verizon needs to demonstrate why the Commission should abandon a forward-looking network approach, that has stood the test of time and litigation, and has succeeded in promoting and protecting competition, in favor of an actual cost approach that would revisit the ills of historical cost ratemaking repudiated by Congress and this Commission. As discussed further below, Verizon faces a high burden in asking the Commission to return to historical cost based ratemaking.

[2] Verizon Petition at 2.

Verizon contends that a forward-looking approach results in UNE rates that are well below what the ILEC can match.[3] The absurdity of this contention is evidenced in the fact that RBOCs still control nearly 90% of the access lines in the United States.[4] If the RBOCs could not match competitive prices, one would expect that percentage to be much smaller. RBOCs can and do match prices every day as demonstrated by the aggressive winback policies they engage in. Moreover, for the fourth quarter 2002 Verizon reported revenue growth and strong sales in regard to its bundled service offerings which would include its local and long distance service.[5] These are not the indications of a carrier that is unable to match competitive prices.

Verizon also contends that TELRIC discourages investment by all carriers.[6] Once again this contention flies in the face of reality. As discussed below, the period of 1996 to early 2001 witnessed unprecedented investment in the telecommunications industry. While it is true that investment has declined in the last two years this has been more the function of a sluggish economy, closed capital markets, and diminished network needs as opposed to a response to TELRIC prices.

Verizon also contends that TELRIC functions as "black box" because it lacks objective criteria or standards on which to base rates and accordingly provides considerable latitude to set rates without regard to costs. The U.S. Supreme Court explicitly rejected this criticism of TELRIC. The Court in fact noted that TELRIC was preferable to prior ratemaking approaches.[7]

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3 Verizon Petition at 2.

4 *Local Telephone Competition: Status as of December 31, 2002*, at 1, Table 1.

5 *Verizon Communications Reports Strong Yearly Operational Growth and Gives Outlook for 2003*, Verizon Press Release (Jan. 29, 2003).

6 Verizon Petition at 2.

7 *Verizon Communications, Inc., et al., v. Federal Communications Commission, et al.,* 122 S.Ct. 1646, 1677 (2002). The Court noted:

> One important potential advantage of the T[E]LRIC approach, however is its relative ease of calculation. Rather than estimate costs reflecting the present [incumbent] network -- a difficult

In fact, the RBOCs, if anything, have benefited from the latitude TELRIC provides because many state commissions have set wholesale prices at points halfway between forward-looking costs and forward-looking costs plus the average retail margin.[8]

Despite this, Verizon bemoans the recent reduction in TELRIC rates that has occurred in many states. This is not unexpected as states have conducted subsequent rounds of TELRIC proceedings and have become more experienced in the process. The FCC noted in the Massachusetts 271 proceeding:

> New developments, technologies, and information, including information as to the kind of switch discounts that would be available if a carrier were building an entire network, have become available since that time. As always, we presume that the Massachusetts Department, like other state commissions, will examine these issues during the course of its ongoing rate case and set rates within the range of what a reasonable application of what TELRIC would produce.[9]

It is not surprising that new developments, technologies, and information will lead to lower rates. Also, it should not be forgotten that many rates were reduced in the context of Section 271

> task even if [incumbents] provided reliable data -- it is possible to generate T[E]LRIC estimates based on a 'green field' approach, which assumes construction of a network from scratch. To the extent that the traditional public- utility model generally relied on embedded costs, similar sorts of complexity in reckoning were exacerbated by an asymmetry of information, much to the utilities' benefit. And what we see from the record suggests that TELRIC rate proceedings are surprisingly smooth- running affairs, with incumbents and competitors typically presenting two conflicting economic models supported by expert testimony, and state commissioners customarily assigning rates based on some predictions from one model and others from its counterpart. At bottom, battles of experts are bound to be part of any ratesetting scheme, and the FCC was reasonable to prefer TELRIC over alternative fixed-cost schemes that preserve home-field advantages for the incumbents.

Id.

8 T.R. Beard, G.S. Ford, C.C. Klein, *The Financial Implications of the UNE-Platform: A Review of the Evidence*, CommLaw Conspectus, Journal of Communications Law and Policy at 8 (Fall/Winter 2003) ("*Beard, et al.*").

9 *Application of Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions) and Verizon Global Networks, Inc. for Authorization to Provide In-Region, InterLATA Services in Massachusetts*, CC Docket No. 01-9, Memorandum Opinion and Order, FCC 01-130, ¶ 35 (Apr. 16, 2001) ("*Massachusetts 271 Order*").

proceedings where RBOCs reduced their rates to become checklist compliant.[10] Now having reaped the benefits of the bargain, RBOCs seek to evade the cost.

Verizon's sole evidence of its claim of "artificially low rates" are a series of financial analysts reports. As a threshold matter, it is important to note that Verizon is asking the Commission to weigh the reports of organizations whose area of expertise is not to conduct cost proceedings over the findings of state commissions who have been setting rates for the RBOCs for years. Surely the state commissions would not allow "artificially low rates" for the RBOCs, and, if in any case they did, it would be subject to reversal by a federal district court. Notably, the RBOCs have not been able to challenge successfully specific UNE rates as confiscatory in any court today. If UNE rates are in fact as artificially low as Verizon claims, the RBOCs should have been able to prove as much in the federal courts. Thus, there is simply no reason for the Commission to disturb the reasoned decision making of these state commissions.

Second, these financial reports are glaringly incomplete. Many of the reports ignore non-recurring charges which are a significant source of revenue to the RBOCs.[11] The reports also significantly understate overall RBOC revenue from wholesale lines.[12] A study conducted by the Phoenix Center for Advanced Legal & Economic Policy Studies found that RBOC wholesale operating costs are significantly less than what is reported by financial analysts.[13] The study also found that RBOC wholesale revenues are significantly higher than what is reported by financial analysts.[14] Commenters are not seeking to impugn financial analyst findings, but just seek to

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[10] See, *e.g.*, *Application by Verizon New Jersey Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance, NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization To Provide In-Region, InterLATA Services in New Jersey*, Memorandum Opinion and Order, WC Docket No. 02-67, FCC 02-189, ¶¶ 61-73 (rel. June 24, 2002).

[11] *Beard, et al.* at 11.

[12] *Beard, et al.* at 13. The understatement ranges from 11% to 43%.

[13] *Beard, et al.* at 19.

[14] *Beard, et al.* at 20.

note that rate comparisons are very complex and require very detailed comparisons. It is clear that evaluations of similar data have led to strongly divergent conclusions. There is simply no basis to reach any definitive conclusions based on statistics Verizon has submitted. This is also the more reason why the Commission must embark on more detailed fact finding before reaching any conclusions. State commissions should also be provided the opportunity to defend their rates.

Verizon also asks the Commission to forbear based on its contention that TELRIC is not required by the Act.[15] In fact, this determination is critical because the Commission is statutorily proscribed from forbearing from the requirements of section 251(c) or 271.[16] Both sections pose obstacles to Verizon's petition. Section 251(c)(3) imposes a duty upon ILEC to provide UNEs based on rates that are just, reasonable and nondiscriminatory in accordance with the requirements of Sections 251 and 252.[17] The Commission held in the *Local Competition Order* that:

> we conclude here that prices for interconnection and unbundled elements pursuant to sections 251(c)(2), 251(c)(3), and 252(d)(1), should be set at forward-looking long-run economic cost. In practice, this will mean that prices are based on the TSLRIC of the network element, which we will call Total Element Long Run Incremental Cost (TELRIC), and will include a reasonable allocation of forward-looking joint and common costs.[18]

Thus, the Commission cannot forbear from the TELRIC requirement until it deems that the requirements of Section 251(c) are fully met. Likewise, Checklist Item 2 of Section 271 states that a Bell Operating Company ("BOC") must provide "nondiscriminatory access to network

15 Verizon Petition at 19.

16 47 U.S.C. § 160(d).

17 47 U.S.C. § 251(c)(3).

18 *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report & Order, 11 FCC Rcd 15499, ¶ 672 (1996) ("*Local Competition Order*"), *aff'd in part and vacated in part sub nom., Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997) and *Iowa*

elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1) of the Act."[19] Section 251(c)(3) requires LECs to provide "nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory . . . ."[20] Section 252(d)(1) mandates that state commissions should determine just and reasonable rates for network elements that are nondiscriminatory and based upon the cost of providing the network element.[21]

In implementing Sections 251(c) and 271, the Commission has determined that prices for UNEs must be based on the total element long run incremental cost ("TELRIC") of providing those elements.[22] The Commission's pricing rules have the same legal significance as the statutory provisions under which they were implemented – Sections 251(c) and 271 -- and, as with those provisions, the Commission cannot forbear from its pricing rules until it determines that the statutory provisions have been fully implemented. As a practical matter, also, the Commission should not forbear from application of TELRIC. This Commission has found that TELRIC is the methodology that furthers the goals of the 1996 Act. The Commission noted:

> The 1996 Act encourages competition by removing barriers to entry and providing an opportunity for potential new entrants to purchase unbundled incumbent LEC network elements to compete efficiently to provide local exchange services. We believe that the prices that potential entrants pay for these elements should reflect forward-looking economic costs in order to encourage efficient levels of investment and entry.[23]

This conclusion was supported by state commissions throughout the U.S. Both incumbents and competitors have operated under this framework. If the Commission is going to alter this

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Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), *aff'd in part and remanded, AT&T v. Iowa Utils. Bd.*, 119 S. Ct. 721 (1999).

19 47 U.S.C. § 271(B)(ii).

20 47 U.S.C. § 251(c)(3).

21 47 U.S.C. § 252(d)(1). The State Commissions may factor in a reasonable profit when basing rates upon costs.

22 *Massachusetts 271 Order*, ¶ 16.

methodology, it must first conduct a proceeding that will establish a sufficient record to support such a departure. An unsubstantiated Petition for Forbearance is not the vehicle for this change.

Verizon's Petition begs the question of whether TELRIC should be modified. Verizon has not substantiated its claims, and as demonstrated above, at a minimum an equally strong case can be made that Verizon's claims are incorrect.

B. TELRIC Pricing Was Affirmed By the Supreme Court.

After nearly six years of appeals, the FCC's TELRIC pricing rules were affirmed by the U.S. Supreme Court in *Verizon*.[24] The Court found that FCC could require state commissions to set rates for leasing of unbundled network elements on a forward-looking basis that was untied to historical or past investment and that the methodology chosen by the FCC was not inconsistent with the plain language of the Act.[25] Perhaps even more important than the ultimate vindication the Court gave this Commission's rules was the strong language throughout the opinion that supported the FCC's TELRIC methodology. In its ruling, the Court considered, and explicitly rejected, many of the arguments that Verizon raises in its Petition.

The Court first observed the sea change that the Telecommunications Act of 1996 effected on historical approaches to ratemaking. The Court noted that under the local competition provisions of the Act, Congress called for ratemaking different from any historical practice, to achieve the entirely new objective of uprooting the monopolies that traditional rate-base methods had perpetuated."[26] This is reflected the admonition in Section 252 that a "rate-

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23 *Local Competition Order*, ¶ 672.

24 *Verizon Communications, Inc., et al., v. Federal Communications Commission, et al.,* 122 S.Ct. 1646 (2002).

25 *Id.*

26 *Id.* at 1660.

of-return or other rate based" methodology *not be used* to determine prices.[27] Rate-of-return proceedings are based upon use of historical costs.[28]

The Court noted that the Act was designed to promote "competition in the persistently monopolistic local markets, which were thought to be the root of natural monopoly in the telecommunications industry," and sought to "eliminate the monopolies enjoyed by the inheritors of AT & T's local franchises."[29] The Court noted that:

> For the first time, Congress passed a ratesetting statute with the aim not just to balance interests between sellers and buyers, but to reorganize markets by rendering regulated utilities' monopolies vulnerable to interlopers, even if that meant swallowing the traditional federal reluctance to intrude into local telephone markets.[30]

The Court noted that from the "constancy of dissatisfaction' with prior rate-making approaches:

> one possible lesson was drawn by Congress in the 1996 Act, which was that regulation using the traditional rate-based methodologies gave monopolies too great an advantage and that the answer lay in moving away from the assumption common to all the rate-based methods, that the monopolistic structure within the discrete markets would endure.[31]

In fact, the fault with past historical cost rate making approaches was that they were often "no match for the capacity of utilities having all the relevant information to manipulate the rate base

27 47 U.S.C. § 252(d)(1)(A)(i)

28 *See Illinois Bell Telephone Company v. FCC*, 988 F.2d 1254, 1258-59 (D.C. Cir. 1993).

29 *Verizon*, at 1654. The Court cited to one of the main proponents of the Act who noted that:

> 'This is extraordinary in the sense of telling private industry that this is what they have to do in order to let the competitors come in and try to beat your economic brains out ....It is kind of almost a jump-start .... I will do everything I have to let you into my business, because we used to be a bottleneck; we used to be a monopoly; we used to control everything. "Now, this legislation says you will not control much of anything. You will have to allow for nondiscriminatory access on an unbundled basis to the network functions and services of the Bell operating companies network that is at least equal in type, quality, and price to the access [a] Bell operating company affords to itself.' 141 Cong. Rec. 15572 (1995). (Remarks of Sen. Breaux (La.) on Pub.L. 104-104 (1995)).

Id. at 1661.

30 *Id.* at 1661.

31 *Id.* at 1660.

and renegotiate the rate of return every time a rate was set."[32] While the RBOCs were migrated to price cap regulation, this did not eliminate the gamesmanship as "there are still battles to be fought over the productivity offset and allowable exogenous costs."[33]

The Court observed that the 1996 Act appears to be an "explicit disavowal of the familiar public-utility model of rate regulation (whether in its fair-value or cost-of-service incarnations) presumably still being applied by many States for retail sales . . . ***in favor of novel ratesetting designed to give aspiring competitors every possible incentive to enter local retail telephone markets***, short of confiscating the incumbents' property."[34] Such a ratemaking approach was necessary given the tremendous advantages that the RBOCs possessed.[35]

TELRIC since it treated cost as a "forward-looking economic cost" met the requirements of the Act because it was distinct from "historically based cost" which had generally been relied upon in valuing a rate base.[36] The Court in rejecting the RBOCs' argument that the Act's definition of cost must be based on their historical, actual costs astutely noted that "a merchant

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32 *Verizon*, 122 S.Ct. at 1660.

33 *Id.* at 1660.

34 *Id.* at 1661.

35 The Court chronicled how control over the local exchange gives ILECs a nearly insurmountable advantage:

> A local exchange is thus a transportation network for communications signals, radiating like a root system from a "central office" (or several offices for larger areas) to individual telephones, faxes, and the like. It is easy to see why a company that owns a local exchange (what the Act calls an "incumbent local exchange carrier," 47 U.S.C. § 251(h)), would have an almost insurmountable competitive advantage not only in routing calls within the exchange, but, through its control of this local market, in the markets for terminal equipment and long-distance calling as well. A newcomer could not compete with the incumbent carrier to provide local service without coming close to replicating the incumbent's entire existing network, the most costly and difficult part of which would be laying down the "last mile" of feeder wire, the local loop, to the thousands (or millions) of terminal points in individual houses and businesses. The incumbent company could also control its local-loop plant so as to connect only with terminals it manufactured or selected, and could place conditions or fees (called "access charges") on long-distance carriers seeking to connect with its network. In an unregulated world, another telecommunications carrier would be forced to comply with these conditions, or it could never reach the customers of a local exchange.

Verizon, 122 S.Ct. at 1662.

36 *Id.* at 1664.

who is asked about the 'cost of providing the goods' he sells may reasonably quote the current wholesale market price, not the cost of the particular items he happens to have on his shelves."[37] The Court observed that ratemakers often rejected the utilities "embedded costs" (their own book value estimates) "which typically were geared to maximize the rate bases with high statements of past expenditures and working capital, combined with unduly low rates of depreciation."[38] Thus, the Court concluded it would be "passing strange to think Congress tied 'cost' to historical cost without a more specific indication. . . . "[39]

The Court also explicitly considered, and rejected, the RBOC's challenge of the TELRIC's use of hypothetical costs.[40] The Court observed that what the "incumbents call the 'hypothetical' element is simply the elements valued in terms of a piece of equipment an incumbent may not own."[41] In fact, the Court noted that the FCC "***would have had some more explaining to do if it had not changed its course by favoring TELRIC over forward-looking methodologies tethered to actual costs***, given Congress's clear intent to depart from past

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37 *Id.* at 1666.

38 *Id.* at 1666.

39 *Id.* at 1667.

40 It warrants emphasizing that the term "hypothetical" is a misnomer in the TELRIC context. The Commission did not choose a "hypothetical" network approach, as Verizon suggests. Rather, the Commission based its pricing rules on the ILECs existing network design and most efficient technology "currently available." As the Commission noted:

> Under the third approach, prices for interconnection and access to unbundled elements would be developed from a forward-looking economic cost methodology based on the most efficient technology deployed in the incumbent LEC's current wire center locations. This approach mitigates incumbent LECs' concerns that a forward-looking pricing methodology ignores existing network design, while basing prices on efficient, new technology that is compatible with the existing infrastructure. This benchmark of forward-looking cost and existing network design most closely represents the incremental costs that incumbents actually expect to incur in making network elements available to new entrants. . . . We, therefore, conclude that the forward-looking pricing methodology for interconnection and unbundled network elements should be based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that the reconstructed local network will employ the most efficient technology for reasonably foreseeable capacity requirements.

Local Competition Order, ¶ 685.

41 *Id.*

ratesetting statutes in passing the 1996 Act."[42] Thus, the Court is explicitly suggesting that an approach such as TELRIC was not only an appropriate choice by the Commission, but perhaps a necessary one. The Court also suggests that the Act explicitly calls for a departure from a focus on the "actual" costs of the RBOCs.

The Court noted the fundamental problem with pricing based on the RBOCs' embedded actual costs:

> As for an embedded-cost methodology, the problem with a method that relies in any part on historical cost, the cost the incumbents say they actually incur in leasing network elements, is that it will pass on to lessees the difference between most-efficient cost and embedded cost. Any such cost difference is an inefficiency, whether caused by poor management resulting in higher operating costs or poor investment strategies that have inflated capital and depreciation. If leased elements were priced according to embedded costs, the incumbents could pass these inefficiencies to competitors in need of their wholesale elements, and to that extent defeat the competitive purpose of forcing efficient choices on all carriers whether incumbents or entrants. The upshot would be higher retail prices consumers would have to pay.[43]

The Court noted that even if "incumbents have built and are operating leased elements at economically efficient costs, the temptation would remain to overstate book costs to ratemaking commissions and so perpetuate the intractable problems that led to the price-cap innovation."[44] The reality, however, is that the RBOCs did not build or run their operations at economically efficient costs.[45]

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42 *Id.* at 1668, n. 20. (emphasis added).

43 *Id.* at 1673.

44 *Id.* at 1673.

45 *Id.* at 1676. As the Court noted:

> we have already noted the consequence of the utilities' approach, that the "book" value or embedded costs of capital presented to traditional ratemaking bodies often bore little resemblance to the economic value of the capital. See FCC Releases Audit Reports on RBOCs' Property Records, Report No. CC 99-3, 1999 WL 95044 (FCC, Feb. 25, 1999) ("[B]ook costs may be overstated by approximately $5 billion"); Huber et al. 116 (We now know that "[b]y the early 1980s, the Bell System had accumulated a vast library of accounting books that belonged alongside dime-store novels and other works of fiction .... By 1987, it was widely estimated that the book value of telephone company investments exceeded market value by $25 billion dollars").

The Court also noted that RBOCs, contrary to having their investments unrecoverable through depreciation, benefited from underdepreciation. The Court stated that:

> As we have described, underdepreciation (to the extent of its continuation today, which the Government disputes, Brief for Respondent Federal Parties 38-39) was undertaken largely by the incumbents themselves, not forced upon them by regulators, as a means to keep the rate base inflated under the public-utility model of regulation. See *supra,* at 1659-1660, 1666. For all we know, the incumbent carriers may yet be seeking low rates of depreciation in state retail-rate proceedings still conducted under that model, even as they seek high depreciation rates here today to factor into the wholesale prices they may charge for the same elements they use to provide retail services. In short, the incumbents have already benefited from underdepreciation in the calculation of retail rates, and there is no reason to allow them further recovery through wholesale rates.[46]

The Court went as far as to note that there even is an argument that the Act explicitly forbids embedded-cost methodologies, and that even though the Commission refrained from this interpretation, "it seems safe to say that the statutory language places a heavy presumption against any method resembling the traditional embedded-cost-of-service model of ratesetting."[47] This is the presumption that Verizon must overcome in promoting its methodology based on its actual costs.

Verizon is asking the Commission to return to the very type of ratemaking Congress sought to proscribe through the 1996 Act. The Court noted that Congress in proscribing traditional rate-of-return approaches was "firing a warning shot to state commissions to steer clear of entrenched practices perceived to perpetuate incumbent monopolies."[48] Both this Commission, and state commissions, rightfully employed a pricing methodology designed to uproot, not perpetuate, monopolies. Verizon's filing of this Petition is a telling sign of the Commission's success. Verizon asks this Commission to return to pre-1996 ratemaking as if the

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Id.

46 *Id.* at 1676, n. 34.

47 *Id.* at 1673.

48 *Id.* at 1674, n. 31.

1996 Act never occurred; however, the language of the Act, and the Supreme Court's ruling, stand in the way.

C. Numerous Studies Show that TELRIC Promotes BOC Investment and Consumer Welfare.

As with many of the other arguments that Verizon has raised, the notion that TELRIC does not spur investment has been unequivocally considered and rejected by the U.S. Supreme Court. The Court noted that "the claim that TELRIC is unreasonable as a matter of law because it stimulates but does not produce facilities-based competition founders on fact."[49] The Court observed that new entrants have invested in facilities to the tune of $55 billion from the passage of the Act to 2000. Moreover, CLECs reinvest a much larger portion of their revenues back into their facilities than the RBOCs, 63.7% to 20.6% respectively.[50]

The Court also observed that the FCC's statistics indicate substantial resort to pure and partial facilities-based competition among the three entry strategies: as of June 30, 2001, 33 percent of entrants were using their own facilities; 23 percent were reselling services; and 44 percent were leasing network elements (26 percent of entrants leasing loops with switching; 18 percent without switching).[51] The Court concluded that "it suffices to say that a regulatory scheme that can boast such substantial competitive capital spending over a 4-year period is not easily described as an unreasonable way to promote competitive investment in facilities."[52] To put it mildly, TELRIC has succeeded.

TELRIC also has not stymied RBOC investment. During the same period, the RBOCs invested over $100 billion. The Phoenix Center reported that the *additional* telecommunications

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49 *Id.* at 1675.
50 *Id.*
51 *Id.* at 1675.
52 *Id.* at 1676.

investment, *i.e.,* over and above what was expected, from 1996 to 2001 was in the range of $267 billion.[53] From 1980 to 1995, telecommunications investment grew at an annual rate of 2.8%, with an average annual investment level of approximately $39 billion. After the 1996 Act, investment grew at an average annual rate of 22.3% with about $95.3 billion being invested annually.[54] Statistics also demonstrate that the RBOC total plant in service continues to rise, and RBOCs invest more significantly in states where there is competition.[55] AT&T conducted a study which unequivocally demonstrated that the highest areas of ILEC investment were in those markets where it was subject to the most UNE-based competition from CLECs.[56] As the Court noted, this reaffirms the "commonsense conclusion that so long as TELRIC brings about some competition, the incumbents will continue to have incentives to invest and to improve their services to hold on to their existing customer base."[57]

A classic proof of the theorem that "if there is competition, RBOC investment will follow" is the fact that competitive provisioning of DSL spurred the RBOCs to deploy DSL service. A former Chief Economist for the FCC attributed the spread of DSL to the consumer market as a direct consequence of unbundling noting that:

> [I]n the case of DSL, the technology was not deployed at all to provide retail, high-speed data services when local exchange companies had regional monopolies. Carriers did not offer DSL service as a consumer product on its own until late in 1996. That year, the Telecommunications Act of 1996 ("the Act") opened the local telephone market to competition. The Act required incumbent telephone companies to lease out elements of their systems for competitors to use to provide service. New entrants were then able to lease copper "loops" that link central offices to customers, install their own DSL equipment and connections to

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53 Phoenix Center Policy Bulletin No. 5, Competition and Bell Company Investment in Telecommunications Plant at 1 (July 9, 2003) (Phoenix Center Bulletin No. 5).

54 Phoenix Center Bulletin, No. 4, The Truth About Telecommunications Investment at 3 (June 24, 2003) (Phoenix Center Bulletin No. 4).

55 Phoenix Center Bulletin No. 5 at 4.

56 CC Docket No. 01-338, Comments of AT&T Corp. at 68-69 (April 5, 2002).

57 *Verizon,* 122 S.Ct. at 1666.

> the internet, and offer high-speed data service to customers that was cheaper and easier to obtain than T1 service.[58]

ILECs have possessed DSL technology since the 1980s, but did not offer it for fear it would impact other lines of business.[59] Only when CLECs and cable companies started offering broadband were the ILECs spurred to enter the DSL market.[60] Now that CLEC DSL deployment is being curtailed, the ILECs are scaling back and raising DSL prices by 25%.[61]

Petitioner, however, ignores the first five years of staggering telecommunications investment, all effected while TELRIC was in place,[62] and instead focuses on the recent downturn in investment. Petitioner contends that this downturn is due to TELRIC, and in particular, the recent decrease in TELRIC rates. Petitioner conveniently ignores other, more likely, causes for the decrease in investment. For instance, reading Verizon's Petition, there is no indication that we have just endured an economic downturn. In fact, no mention is made of the fact that capital expenditures are down for companies across a broad spectrum of industries due to the closing of capital markets. Studies show that investment by telecommunications firms is caused by economic growth, but not vice versa.[63] Capital expenditures are down because there is no capital to invest. In addition, it is also expected that after a spurt of initial investment, investment will decline once initial network construction nears completion.[64]

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58 Phoenix Center Bulletin No. 5 at 6, *citing,* H.A. Shelanksi, Competition & Deployment of New Technology in U.S. Telecommunications, U. Chi. Legal. F. 85 (2000).

59 *Id.* at 75.

60 *Id.*

61 *Id.*

62 While the FCC stayed its pricing rules, the vast majority of state commissions independently utilized the TELRIC methodology. Brief for Petitioners Federal Communications Commission and the United States at 8, 21, n. 12, *Verizon Communications, Inc., et al. v. Federal Communications Commission et al., cert. granted,* 531 U.S. 1124 (Jan. 22, 2001), *opinion issued, Verizon Communications, Inc. v. FCC,* 122 S.Ct. 1646 (2002).

63 Phoenix Center Bulletin No. 5 at 8, *citing,* R.O. Beil, G.S. Ford, and J.D. Jackson, *On the Relationship between Telecommunications Investment and Economic Growth in the United States* (June 2003).

64 Phoenix Center Bulletin No. 5 at 7.

The Court also rejected the idea that TELRIC should be tweaked to promote investment. The Court noted that the RBOCs argued that some degree of long-run inefficiency ought to be preserved in order to give an entrant an efficient alternative to leasing, *i.e.,* building its own facilities. The Court noted the inherent flaw in this approach was that it perpetuates economic inefficiency and creates barriers to entry.[65]

Verizon argues that use of TELRIC will distort the investment decisions of new entrants because "no company will deploy and scale facilities if it can achieve similar economics immediately by renting network elements from the ILECs . . . ."[66] Verizon fails to consider the corollary of their argument. Setting prices at historical, or actual, costs levels, above long-run economic cost, will either (1) encourage inefficient facilities-based entry by rivals with costs below the ILECs' historical costs, but above the ILECs' economically meaningful forward-looking costs or (2) choke off entry altogether. Efficiency dictates that the build-buy decision be made based upon forward-looking, not historical, costs. If an RBOC can build a loop on a forward-looking basis for $15, but the RBOC's historical cost is $30, the CLEC should be

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65 The Court observed that:

> The first objection turns on the fact that a lease rate that compensates the lessor for some degree of existing inefficiency (at least from the perspective of the long run) is simply a higher rate, and the difference between such a higher rate and the TELRIC rate could be the difference that keeps a potential competitor from entering the market. See n. 27, *infra.* Cf. First Report and Order ¶ 378 ("[I]n some areas, the most efficient means of providing competing service may be through the use of unbundled loops. In such cases, preventing access to unbundled loops would either discourage a potential competitor from entering the market in that area, thereby denying those consumers the benefits of competition, or cause the competitor to construct unnecessarily duplicative facilities, thereby misallocating societal resources"). If the TELRIC rate for bottleneck elements is $100 and for other elements (say switches) is $10, an entering competitor that can provide its own, more efficient switch at what amounts to a $7 rate can enter the market for $107. If the lease rate for the bottleneck elements were higher (say, $110) to reflect some of the inefficiency of bottleneck elements that actually cost the incumbent $150, then the entrant with only $107 will be kept out. Is it better to risk keeping more potential entrants out, or to induce them to compete in less capital-intensive facilities with lessened incentives to build their own bottleneck facilities? It was not obviously unreasonable for the FCC to prefer the latter.

Id. at 1672.

presented with a $15 price to buy the loop from the RBOC. If presented with an option to buy the loop from the RBOC for $30, and if the CLEC's cost to build the loop itself is $20, it will either inefficiently build the loop itself, even though the RBOC is the more efficient builder, or not enter the market at all. The folly of Verizon's argument is that it encourages the wasteful construction of duplicative facilities and stifles market entry.

TELRIC encourages efficient entry and precludes the wasteful deployment of facilities as demonstrated by the example above, because the new entrant will make the decision to build based on what is the most efficient and cost-effective option. As Justice Breyer noted:

> [o]ne can understand the basic logic of "unbundling" by imagining that Congress required a sole incumbent railroad providing service between City A and City B to share certain basic facilities, say, bridges, rights-of-way, or tracks, in order to avoid wasteful duplication of those hard-to-duplicate resources while facilitating competition in the *remaining* aspects of A-to-B railroad service. Indeed, one might characterize the Act's basic purpose as seeking to bring about, without inordinate waste, greater local service competition . . . .[67]

Congress did not want to encourage wasteful duplication of facilities by new entrants. Under TELRIC, if the economic cost to the new entrant dictates that the construction of its own facilities is more efficient and cost-effective, it will build the facilities.

The problem with the historical cost approach is that:

> [p]ermitting incumbent LECs to recover embedded costs in the prices they charge competitors for interconnection and unbundled network elements, while the incumbents experience much lower incremental costs, will result in inefficiently high prices that will either cause new entrants to over-build existing systems instead of maximizing the efficient use of the existing incumbent LEC's

66 Verizon Petition at 6.

67 *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366, 416-417 (1999) (Breyer, J., concurring in part/dissenting in part).

> network, or discourage entry and investment in the local market altogether.[68]

II. FORBEARANCE WOULD UNLAWFULLY ASSUME THE VALIDITY OF VERIZON'S VIEWS PENDING RULEMAKING

The Commission cannot make any ruling on Verizon's request for forbearance until it evaluates the validity of Verizon's predicate argument that TELRIC is flawed. The Commission is poised to embark on such a comprehensive rulemaking to revisit issues surrounding TELRIC. That is the correct vehicle to address the issues Verizon raises. Granting Verizon's Petition, in any part, would prejudge the issues in that proceeding, and on a less than ideal record. The Commission would have to determine that a focus on actual embedded costs, as opposed to economically efficient, forward-looking costs is more suited to promoting competition and promoting investment. The Commission would have to determine that a full application of TELRIC principles is no longer necessary or warranted. The Commission would also have to determine that UNE prices are in fact too low without having benefit of the review of cost data that state commissions have reviewed and evaluated.

Commenters are particularly concerned that Verizon is asking the Commission to make these determinations in the context of one particular industry segment, *i.e.*, the UNE Platform. While Verizon couches its attack on TELRIC as a UNE Platform issue, the fear is that any Commission determination would impact the Commission's determinations on TELRIC in regard to facilities-based carriers. While the relief sought focuses on the UNE-Platform, the rulings necessary to get to that point implicate pricing for all facilities. Moreover, while facilities-based carriers may not rely on the switching of the RBOCs, loops and transport

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68 *Local Competition Order*, ¶ 655.

facilities are also components of the Platform, and any Commission ruling would have implications for carriers that lease those facilities. This is all the more reason why these issues should be considered in an omnibus proceeding where a more comprehensive record can be created.

III. CLECs USING UNES MAY COLLECT ACCESS CHARGES

A. CLECs Are the Providers of Access Service.

Verizon argues that CLECs utilizing UNE-P should not be entitled to collect access charges from other carriers because it is the ILEC, not the CLEC, that is actually providing the access service.[69] The Commission should reject this argument for the very good reason that it has already determined that CLECs using UNEs are providers of access service and entitled to collect access charges.

When a CLEC purchases UNEs the CLEC becomes the service provider over those facilities. The CLEC is responsible for customer billing and customer service and, in most cases, the customer is not even aware that it is receiving service over facilities leased from another carrier. In addition, access services terminating to those facilities will be in all likelihood terminating to the CLEC's customer, not the ILEC's customer. In such cases, it is the CLEC, not the ILEC, that has a relationship to the access customer.

For example, as providers of competitive exchange access services, CLECs are permitted to collect terminating access charges for exchange access traffic terminated to a CLEC's facilities.[70] Nothing in the Commission's access rules requires that a CLEC actually own the facilities to be permitted to collect access charges. Rather, as in many cases in which a lessee is

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69 Verizon Petition at 4, 14-18.

permitted to collect fees from users of the leased property, a CLEC that is leasing UNEs, including UNE-P, from an ILEC is permitted to collect charges for third-parties use of those facilities.

In addition, collecting access charges on purchased UNE facilities enables a CLEC to recoup a portion of the cost of those facilities. As Verizon notes,[71] exchange access charges were designed as a way to help pay for the underlying infrastructure. In a case where the ILEC is providing access service over its own facilities, the ILEC recovers a portion of the cost of those facilities directly from the terminating access carrier. In a case where the ILEC is providing UNEs, including UNE-P, to a CLEC, the costs of the underlying network are recovered through the ILEC's TELRIC-based UNE rates. There is no reason to permit the ILEC to double recover its costs by also collecting access charges for exchange access traffic terminating to those facilities.[72]

On the other hand, it is reasonable to permit the CLEC purchasing the UNEs to recover a portion of its costs – the UNE charges paid to the ILEC to reimburse it for the cost of the facilities. In fact, under such a regime, the access charges still indirectly help pay for the cost of the underlying infrastructure because a portion of the access charge revenues collected by the CLEC are in turn paid to the ILEC as UNE charges. Thus, contrary to Verizon's claim, the only thing that would change if the Commission grants Verizon's Petition would be that Verizon could then recognize a windfall in the form of additional access revenues, while its competitor,

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70 *Access Charge Reform*; *Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, FCC 01-146, ¶ 8 (rel. April 27, 2001).

71 Verizon Petition at 14.

72 *Access Charge Reform*, CC Docket 96-262, First Report and Order, 12 FCC Rcd 15982, ¶ 337 (1997) ("*Access Charge Reform Order*"), *aff'd sub. nom. Southwestern Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998) ("Allowing incumbent LECs to recover access charges in addition to the reasonable cost of such facilities would constitute double recovery because the ability to provide access services is already included in the cost of the access

the CLEC, would be precluded from recovering a portion of its costs. Only Verizon wins under that scenario, at the expense of competition and the public interest.

Fourth, Verizon has offered no valid basis to alter the existing rules. As noted above, the FCC expressly declined to permit ILECs to collect access charges when they provide UNEs.[73] The Commission concluded that ILECs recover the cost of their networks through cost-based UNE rates and that permitting them to also recover access charges would promote double recovery.[74] Verizon has not offered any valid basis for changing or forbearing from this finding or the rules the followed from that finding.

B. Verizon Is Attempting to Grab Additional Access Revenue.

While Verizon claims that CLECs are trying to make huge profits from access charges,[75] the fact is that Verizon is trying to increase the amount it receives for UNEs beyond what has been found to be TELRIC-compliant ***and***, at the same time, transfer the access revenues in question to itself. In essence, Verizon wants to double dip – recover at least the cost of its facilities through UNE charges and receive windfall access revenues for the same facilities. Verizon's argument is a perfect example of monopolistic thinking. In Verizon's world, it is perfectly reasonable to overcharge your competitors for facilities that you control and then simultaneously forbid the purchasers of those facilities from recovering a portion of their costs through access charges. Indeed, under Verizon's reasoning applied to the local exchange market, a CLEC purchasing UNEs from Verizon should not be permitted to charge for local service

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facilities themselves. Excluding access charges from unbundled elements ensures that unbundled elements can be used to provide services at competitive levels, promoting the underlying purpose of the 1996 Act.").

73 *See Access Charge Reform Order*, at ¶ 337.

74 *Id.*

75 Verizon ignores the fact that any "profit" a CLEC may recognize through access charges has already been limited by the Commission's *Benchmark Order* requiring CLECs, over a three-year phase-in, to lower their access charges to the same level as the ILEC in that serving area. *In the Matter of Access Charge Reform*; *Reform of*

provided to its customer because Verizon is the entity actually providing service over those facilities.[76] Clearly, competition would not last long under such a regime. For the same reasons, Verizon's proposal to collect access charges on UNE-P facilities should be rejected in favor of competition and the public interest.

IV. INTERIM RELIEF IS UNNECESSARY

A. BOCS Are Experiencing Robust Financial Performance.

As noted above, the RBOCs' financial performance is hardly suffering due to TELRIC pricing. In fact, their performance could be termed "robust" at least in comparison to other industries affected by the economic downturn. SBC reported second-quarter results that included the best quarter ever reported by a Bell company for net adds in DSL service.[77] SBC notes that it "changed the competitive landscape" by introducing "highly attractive rates" and "innovative product bundles" that "have delivered outstanding results in terms of new sales, customer retention and improved stability in our core business." SBC, therefore, seems to have no problem responding to competitive pricing. BellSouth reported increased earnings per share for the second quarter 2003 as compared to second quarter 2002.[78] Its bundled packages "fueled retention and reacquisition of residential and small business customers." It should be emphasized that these financial results, which hardly portray afflicted, much less dying companies, are reported during what is purportedly the height of reduced UNE rates.

B. Forbearance Would Disrupt State Triennial Review Implementation Proceedings.

Among other reasons, The Commission may not forbear pending its TELRIC rulemaking because forbearance would unlawfully prejudge that rulemaking. Forbearance would also be

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Access Charges Imposed by Competitive Local Exchange Carriers, Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, FCC 01-146 (rel. April 27, 2001) ("*Benchmark Order*").

76 Verizon Petition at 14.

77 *SBC Reports Second-Quarter Diluted EPS of $0.42*, SBC Communications Press Release (July 24, 2003).

unduly disruptive of state proceedings implementing the *Triennial Review Order.* While the order has not been released, and the details remain unknown to the industry, the FCC apparently will permit states to play a significant role in administering and applying impairment criteria for UNE-P. The Commission has apparently established 90 day and 9 month limits for state proceedings dealing with larger business customers and mass market customers respectively.[79] It would make little sense for the Commission to change the rules for UNE-P after, or even during, state proceedings. This would cause a waste of state resources and unduly disrupt implementation of the Commission's own rules.

Moreover, in the *Triennial Review Press Release*, the Commission noted that it would not immediately require the transition of customers currently served by UNE-P. Rather, the Commission stated that if a state commission made a finding of no impairment in a particular market, carriers would be required to transition customers from UNE-P.[80] Forbearing from the current UNE-P pricing or removing CLECs' ability to recover access charges on UNE-P facilities could undermine the purpose of the three-year transition, forcing carries to immediately switch customers served through UNE-P, find alternative ways to serve those customers, or bear the additional costs until the states complete their impairment analyses.

Accordingly, if for no other reason, the Commission should deny Verizon's petition in order to preserve an orderly implementation of the Commission's new UNE rules.

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78 *BellSouth Reports Second Quarter Earnings*, BellSouth Press Release (July 23, 2003).

79 *Triennial Review Press Release*, at pp. 1-2 (rel. Feb. 20, 2003).

80 *Triennial Review Press Release*, at 2; *Attachment to Triennial Review Press Release*, at 1.

V. THE PETITION FAILS TO SATISFY THE STATUTORY TEST FOR FORBEARANCE

A. The Current UNE Pricing Rules Are Necessary to Ensure Just and Reasonable Charges, Practices and Classifications.

As it does throughout it Petition, Verizon claims that because the current pricing rules do not permit ILECs to recover the cost of their facilities, the rules are not necessary to ensure just and reasonable charges, practices, classifications and regulations. In other words, in Verizon's opinion, the pricing regime is not necessary because it prevents Verizon from overcharging competitors. That is precisely the reason the rules are necessary.

The requirement that a rate regime ensure that rates are not unjust and unreasonable is meant to protect against excessive rates, not those that are just and reasonable and based upon appropriate cost and profit assumptions. A just and reasonable rate regime is not meant to protect monopolists' profits. The rates produced by such a regime therefore are not "below any rational measure of costs," but are within the zone of reasonableness supported by the forward-looking costs of a reasonably efficient incumbent. Indeed, it is because of the competitive protections inherent in the just and reasonable standard of UNE rates that those rates are not monopoly rents that completely foreclose or severely limit competitive market entry.

Similarly, the current pricing rules do ensure nondiscriminatory charges, practices, classifications and regulations. As discussed above, the pricing rules ensure that Verizon does not discriminate against its competitors. Forbearing from those rules would permit Verizon and other ILECs to impose excessive UNE rate on CLECs. At the same time, forbearing from the current access rules, and thus prohibiting CLECs from recovering their UNE costs through access charges, would further discriminate against CLECs and harm competition and the public interest.

The Commission's pricing rules are not intended to protect against CLECs discriminating against one another, as Verizon suggests. Rather, the rules are intended to prevent ILECs, such as Verizon, from discriminating against CLECs. In the absence of such rules, there are no effective protections in place to ensure that the rates ILECs charge for UNEs are just and reasonable and nondiscriminatory. Similarly, Verizon's claim that the current rules discriminate against ILECs can be rejected out of hand. This argument can be boiled down to a claim that any rule that reduces Verizon's profits is inappropriate and should be eliminated. As much as Verizon may wish it were so, the Commission's pricing rules are not intended to protect Verizon's monopoly status and ensure its profits. The rules are meant to adequately compensate Verizon for the forward-looking costs associated with operating its network, and to promote competition and consumer options and they do just that. Verizon offers no reason to change the current rules.

Focusing on its inability to leverage even greater profits out its competitors, Verizon ignores the fact that its UNE rates are not determined arbitrarily or in a vacuum. Rather, they are determined based upon the cost data provided by Verizon. If that data produces rates that are below Verizon's costs, Verizon can only blame its own failure to measure its forward-looking costs accurately.[81] Alternatively, Verizon can lower its costs or, as Verizon puts it "make business decisions about how best to recover its costs over [the] full range of services and customers."[82] Irrespective of how Verizon chooses to recover its underestimate of its costs, the

81 While UNE rate proceeding may ultimately result in rates below those proposed by the ILEC, the rates are nonetheless based upon the ILEC's proffered cost data adjusted to account for errors, inconsistencies or deviations in the ILEC's cost studies. Nonetheless, an ILEC, such as Verizon, has ample opportunity in each case to demonstrate its actual costs and the rates necessary to recover those costs. If the ILEC fails to do so, it cannot then ask the Commission to punish its competitors.

82 Verizon Petition at 21.

Commission should not permit Verizon to foist its shortfalls on its competitors in order to protect its profits.

Verizon's claim that there is an alternative to the current pricing rules is also without merit and should be rejected. Not surprisingly, Verizon's alternative to increasing UNE rates, and thus benefiting Verizon, is to remove the ability of CLECs to recover their UNE costs through access charges. In other words, a heads Verizon wins, tails CLECs lose proposal. As discussed above, there is no reason, other than contributing to Verizon's already enormous access charge profits, to preclude CLECs from recovering some of the costs of purchasing UNEs through access charge revenues. Indeed, doing so would be inconsistent with the standards for forbearance as it would be contrary to the public interest and would harm rather than protect consumers.

In a declining financial market in which the availability of capital for network deployment is limited, the ability of a CLEC to develop and offer unique services to consumers over UNE facilities creates innovative, competitive alternatives that would otherwise not be available to consumers. In this way, an innovative CLEC can acquire and/or retain customers served through UNEs until market conditions enable the CLEC to renew deployment of its own facilities. Forbearing from the existing pricing rules would eliminate this option for competitors and thus, potentially foreclose the availability of such innovative, competitive services to consumers. Verizon has offered no valid reason to thus harm consumers and the public interest.

B. The Current UNE Pricing Rules Are Necessary to Protect Competition.

Verizon is also wrong that the current pricing rules are not necessary to protect consumers. Lower UNE rates produce more competitive options and ultimately lower the cost of telecommunications services to consumers. If the Commission were to forbear from its current

UNE pricing rules or prohibit CLECs from collecting access charges on UNE facilities, many competitors would be unable to enter or remain in the market, which would reduce the number of competitive options available to and would ultimately harm consumers.[83] Rather than restricting customer choice, as Verizon erroneously suggests,[84] the existing pricing rules encourage investment and enable CLECs to provide competitive service alternatives to consumers. The Commission has recognized that the availability of UNEs enables competitors to enter a new market immediately, begin signing up customers and generating revenues, which can, in turn offset some of the costs of network deployment, while their networks are being deployed.[85] Similarly, in some cases, utilizing UNEs to serve customers can more efficient than deploying redundant facilities prior to a time when those facilities are needed or are economic. This efficiency, in turn, produces competitive rates for consumers and avoids the costs to the market of underutilized, duplicative facilities. Regardless of the variety or quality of a competitor's service offerings, those benefits may not be economically available to consumers if the CLEC has been forced to deploy expensive, redundant facilities prematurely, which is the "investment" Verizon encourages.

In addition, as discussed above, a CLEC relying upon UNEs has the flexibility to provide a broad range of competitive service offerings to consumers. Through these facilities, together with the CLEC's own network, the CLEC can develop an unlimited variety of high-quality, innovative telecommunications service offerings to the public. Foreclosing the flexibility provided by UNEs or making them less economic by prohibiting CLECs from recovering access

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83 *Access Charge Reform Order*, at ¶ 337 ("Excluding access charges from unbundled elements ensures that unbundled elements can be used to provide services at competitive levels, promoting the underlying purpose of the 1996 Act. If incumbent LECs added access charges to the sale of unbundled elements, the added cost to competitive LECs would impair, if not foreclose, their ability to offer competitive access services.")

84 Verizon Petition at 21.

charges on UNE facilities, rather than promoting customer options, could actually reduce the number of competitors in a market, thereby effectively reducing the competitive options available to consumers in that market.

Moreover, contrary to Verizon's claims, and as noted above, reasonable UNE rates have not discouraged investment in new facilities. Prior to the decline in the financial markets and the resulting reduction in available capital for telecommunications carriers, ILECs and CLECs both invested billions of dollars in new infrastructure. The availability of reasonably priced UNEs contributed to this development by enabling CLECs to enter new markets immediately and begin attracting customers and generating revenues while their networks were being deployed.

Rather than addressing this performance, Verizon chooses to focus on the period since the decline in the capital markets. Throughout its Petition, Verizon cites this period as evidence that UNE pricing, and UNE-P in particular, have caused a reduction in investment.[86] The overall decline of the financial markets, including as Verizon noted the $2 trillion decline in the capitalization of the telecommunications industry since 2000,[87] is significantly more likely to have contributed to the decline in infrastructure investment and network deployment than is a reduction in UNE rates. Yet Verizon ignores the clear implications of this data.

In fact, in a declining market, in which additional capital is unavailable or difficult to obtain, industry participants, both ILECs and CLECs, turn to reducing costs to protect revenues and cash flow. In such an environment, the lower initial costs of UNEs, which significantly utilize existing facilities and therefore do not require the expenditure of additional capital by the ILEC, become more attractive to competitive providers and new entrants. Thus, using UNEs

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[85] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, FCC 99-238, at ¶ 6 (Nov. 5, 1999) ("*UNE Remand Order*").

[86] Verizon Petition at 5-9, 19-21.

instead of deploying more capital intensive infrastructure is not only understandable, but makes good business sense. Therefore, while Verizon cites allegedly lower UNE rates and an increase in CLEC use of UNEs as the reason for the decline in investment, the exact opposite is likely true – the decline in availability of capital in the telecommunications industry is the reason for downward pressure on UNE rates and increased CLEC use of UNEs.

Moreover, as noted above, Verizon's investment over the last several years has actually increased in those markets in which it is subject to competition. This proves that, contrary to Verizon's claims, the existing pricing rules are actually encouraging investment, and in particular ILEC investment, in new facilities as a result of the competition provided by the current prices.

C. The Existing Pricing Rules Are Necessary to Promote the Public Interest.

As discussed above, Verizon's claims that the current pricing rules have contributed to the decline in telecommunications investment is completely unfounded, logically flawed and should be rejected in their entirety. In fact, in a declining market, it is all the more important that the Commission refrain from drastically altering the existing regulatory environment. Investors are already reluctant to invest in the telecommunications industry in general and in competitive carriers in particular. Altering the existing UNE pricing and access charge rules as Verizon suggests will send a negative signal to the investment community and will have a significant chilling effect on investment in competitive carriers. The public interest requires that the Commission reject Verizon's request and retain its existing UNE pricing and access charges rules.

Moreover, as explained in detail above, the existing UNE pricing rules promote investment in new facilities by enabling CLECs to enter new markets immediately and begin

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[87] Verizon Petition at 5.

serving customers so that they can plan and deploy their networks effectively and efficiently. While redundant facilities may be in the public interest, it is not in the public interest to have multiple carriers deploying facilities in the same locations simply because they have no alternative to serve customers. Consumers are not well served by the existence of multiple competing providers if one or more of those providers ultimately has to leave the market, transfer it facilities or otherwise discontinue service because of forced facilities deployment. In addition, when a competitive carrier first enters a market, there are a number of uncertainties that weigh against the immediate expenditure of capital to construct a duplication of the ILEC's facilities. Among other things, it is uncertain whether the new entrant will be able to attract customers, whether those customers will remain with the new entrant long enough to complete its facilities, let alone recoup the costs of those facilities, or precisely which areas the new entrant can most efficiently serve. In many cases, a new entrant's initial customers are spread across a particular market and are not located in such a manner as to enable the CLEC to construct facilities efficiently to each customer. The availability of purchased UNEs provides the new entrant with a less costly and more efficient alternative to deploying its own facilities immediately in a haphazard manner.

In addition, even after a CLEC determines when and where it will deploy its network, the actual construction of the network takes time and even in the best circumstances cannot completely duplicate the ubiquitous network of the ILEC. As a result, the facilities-based CLEC may still have to rely on some UNEs purchased from the ILEC in order to complete its network or to serve customers that it is otherwise unable to reach. A regulatory regime in which every carrier, including those that are only just entering a particular market, is required to construct facilities to every customer, will produce an over duplication of facilities, with a corresponding waste of resources, with little or no offsetting public interest benefit. In addition, such a regime will not produce lower costs to consumers because every carrier will have substantial network investment to recover, and thus, will either have to pass those costs on to its consumers or bear the costs themselves and risk financial shortfalls. The former alternative produces inflated costs throughout the market, the latter option creates uncertainty, instability and a lack of consumer confidence; neither alternative promotes the public interest.

Rather, the public interest is best served by a regulatory regime that not only enables new entrants to obtain access to facilities to serve their customers immediately, and thus establish themselves in the market, but also provides the CLEC the flexibility to determine when and where to deploy its own facilities to duplicate the ILEC's network. In this environment, consumers are provided multiple, competitive options for their telecommunications services and carriers are able to plan and deploy their networks in a cost-effective, forward-looking and efficient manner. The current UNE pricing and access rules provide such an environment. Verizon's forbearance proposal, on the other hand, may increase Verizon's profits, but it will lead to fewer options for consumers and unnecessary and inefficient facility construction. Accordingly, while preserving Verizon's monopoly status and enormous profits does not promote the public interest, retaining the existing pricing rules, and all of the pro-competitive, pro-consumer benefits that arise out of those rules does.

VI. CONCLUSION

The Commission should deny Verizon's request for forbearance.

Respectfully submitted,

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